

Chain Store Age **EXECUTIVE**

with Shopping Center Age

The newsmagazine for retail operators

June 1985



Special study

PRODUCTIVITY



Numbers on the upswing

TWENTY DOLLARS A YEAR (USA)

CONTENTS

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Multinationals hedge against currency shifts 15
Erosion of foreign currencies against the dollar is translating into depressed figures on U.S. financial statements.

Sears looking to Discover credit card market 17
The chain is primed to launch a full-scale attack on such industry giants as Visa, MasterCard and American Express.

Combos take the lead in performance race 20
Chain Store Age Executive's exclusive supermarket productivity survey shows combo stores to be consistently high yielders.

Single ply roofing: Is skepticism warranted? 43
A system should be purchased on its own merits and then the warranty should be examined and weighed.

Buy American policy seeks to keep production at home 47
Wal-Mart's campaign aims at buying quality merchandise at competitive prices from United States manufacturers.

Productivity up, costs down with Ross Stores' system 59
In less than nine months, the California-based chain showed a 50% increase in productivity at its new distribution center.

RETAIL TECHNOLOGY

Chains play major roles as EFT moves to center stage 29
The number of merchants installing electronic funds transfer systems is growing as networks expand their bases.

Supermarkets launch test of Spaceman II 34

SHOPPING CENTER AGE

Boomtown demographics prompt upscale mall 51
The \$105 million Anchorage Fifth Avenue project is being built in a market where per capita income is \$35,000.

Inner-city centers integrate public service and profits 52
Developer Alexander Haagen sees opportunities in building centers for "equal-opportunity shopping."

- | | |
|--------------------------------------|----------------------------------|
| 5 From the Editor's Desk | 41 What's in Store |
| 6 Washington Commentary | 55 On the Level |
| 9 Accounting Views | 55 New Stores & Shopping Centers |
| 10 SPECS Forum | 63 Classified Advertising |
| 10 F.Y.I. | 64 Advertising Index |
| 13 Executive Eye on Law & Government | 66 People in the News |

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institutions. There are still other ways to hedge on foreign exchange transactions, such as by dealing in currency futures.

The International Monetary Market (IMM), a division of the Chicago Mercantile Exchange, trades these standardized contracts in such denominations as the British pound, Canadian dollar, French franc, Japanese yen, Swiss franc and West German mark.

"We currently do not use futures contracts," Cannon says, "but we're looking at them actively."

As it happens, Woolworth didn't need to hedge much on foreign currency dividends for the last couple of years. It kept its foreign cash offshore—due to the large domestic tax-loss carryforward that resulted from the shutdown of the U.S. Woolco division in 1982.

In that same year, though, the company was able to save nearly \$14 million by hedging the proceeds from the sale of its British subsidiary (see accompanying story). And since the Woolco tax shield will be exhausted in 1985, Woolworth has resumed bringing in foreign dividends—and hedging them, if need be.

Unlike Woolworth, many organizations don't believe in covering the income from their foreign divisions or simply feel little need to do so.

Consider K mart, which reported net profits of \$9.8 million from its Canadian operations and \$20.7 million from its Australian investments (primarily equity income in mass merchant G.J. Coles) for the year ended Jan. 30.

As far as foreign income is concerned, "We don't employ any hedge programs," says Helen C. Lefler, vp and treasurer at K mart. She notes that the contribution of offshore operations is relatively insignificant. Still, the company might take steps to protect that money in the future. "[Assistant treasurer] Leonard [J. Maida] is looking into all of these matters," she says. "I would think that we'll be looking at it."

There are also companies that won't hedge foreign income but will cover foreign assets and liabilities. One way businesses protect the value of their foreign assets, according to Citicorp economist Kevin Logan, is by balancing them with an equivalent amount of liabilities in the same country.

Sears, on the other hand, hedges certain foreign borrowings with forward contracts.

A number of multinationals, as a matter of principle, rarely engage in any form of foreign currency hedging, Logan says. Some don't think it's worth the time and expense since,

they assert, currency values balance off in the long run.

The way Logan sees it, hedging is akin to speculation simply because the hedger takes a position on the rise or fall of those currencies. "The hedger is trying to eliminate all risk," he says. "But you're always accepting the risk of one alternative vs. another. With hedging you can secure a result,

but you eliminate a possible better result."

Any retailer operating across borders is a risk-taker. Along with that risk, however, comes the chance that a foreign economy will outperform that of the U.S., and that makes doing business abroad just one more brand of hedging. ■

—Gary Vineberg

CREDIT MARKETING

Sears looking to Discover credit card consumer market



No stranger to the workings of plastic, Sears, Roebuck currently has nearly as many charge cardholders as MasterCard (see accompanying chart), with over \$13 billion in receivables. In the past year, it added nearly two million new accounts.

Now Sears is primed to launch a full-scale attack to build a credit card business that will come head to head with industry giants MasterCard, Visa and American Express. The key to its success, however, might be how many competitive retailers it manages to persuade to accept the card.

"I suppose if it became important enough as a card, competing retailers would take it after denying that they would," speculates Malcolm Sherman, president of Zayre Stores. "They would end up taking it if it became an important card, if there's enough penetration, even though they hate helping to enrich a competitor. Do I visualize Zayre being the first people to take it? No."

Besides Zayre, at least one other Sears' competitor, J. C. Penney, "is not likely to accept the card," says Ted L. Spurlock, Penney's vp, director of credit and consumer banking services. "The reason being that we have approximately two-thirds of the

base they work from already on our card and that doesn't leave us much room for our margin for incremental sales-plus business."

"However," he continues, "Penney is consumer driven and when our consumer wants us to accept something, we usually do it. That's what happened with the bank cards and American Express."

A major enticement for consumers may be that the Sears' Discover Card will enable cardholders to take advantage of the wide range of services that has already been established through the Sears Financial Network.

Sears describes the new general purpose card as a "multifeature family financial services card offering revolving credit, savings instruments, electronic services, insurance and other financial planning services."

Discover will be pilot marketed in Atlanta later this year, with a national rollout scheduled for 1986.

The company is banking on two factors to give it an edge in the already fiercely competitive market: a broad base of consumers, most of whom are already familiar with affiliated Sears financial institutions comprising the Sears Financial Network, and a package of financial services not yet avail-

able through any other single card.

Brennan noted that 38% of Sears credit cardholders surveyed last summer indicated they'd use the new Discover Card. Another 29% of non-Sears cardholders also said they'd make use of it.

Like other competing cards, Discover will offer consumers revolving credit, emergency cash, check cashing and lost or stolen card protection.

"But Discover will be more than just another credit card," Brennan

work throughout California. There are now nearly 100 fully operational SearsNet locations.

Finally, cardholders will be offered merchant-related discounts and premiums from Sears and other as-yet-to-be-announced companies.

Besides some of these more tangible benefits, another point in Sears favor that will aid consumer penetration is its target market. "Instead of focusing on narrow income and net worth market segments, we want to

Card, Visa, American Express or Citicorp for dozens of reasons, he says. Among them are Sears' lack of a network to sign on a substantial number of retailers, as well as the lack of an efficient, speedy credit-authorization network that could match that of bank and travel and entertainment cards.

Also, he says, Sears would have to charge merchants under 2% as an incentive to sign on. Consumers would only be attracted if they were charged under \$12 annually.

Another option would be for Sears to offer the card free or to charge a transaction fee. All of which, Nilson claims, would cut into card revenues. (Sears has not yet announced merchant and consumer fees.)

And finally, Nilson states, Sears current card base "does not translate into demographic competition for bank and T&E cards [travel and entertainment cards such as American Express, Carte Blanche and Diners Club] since half of their cardholders couldn't qualify for a MasterCard or Visa card if they wanted one and less than 1 in 10 could get a T&E card."

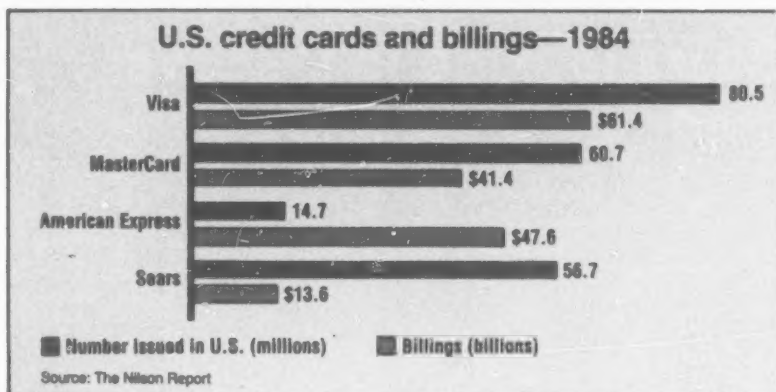
Another stumbling block cited by observers is the reluctance of competing merchants to accept the card.

Brennan claims consumers will be drawn to Discover by its ability to help them save and invest as well as spend. Merchants, he maintains, will be attracted by the opportunity for incremental sales, competitive discount rates and various settlement options.

Penney's Spurlock feels that Sears will be successful in enticing "some" retailers, but that perhaps initially the company will be in a better position to sign on members of the travel and entertainment industry. Once these businesses are signed, consumers would find the card more desirable.

In fact, at presstime, American Airlines had announced it would participate in the Atlanta pilot. However, the Dallas-based carrier had not committed to accepting the card once next year's rollout begins. Delta Airlines was reportedly also meeting with Sears' representatives at presstime. TWA, Eastern and United had not yet committed to participation.

Spurlock wouldn't comment on how the success of Discover would influence Penney's own introduction of a general purpose business card. Yet, he did make one observation that could be considered prognostic: "The financial services industry is turning and undoubtedly all of us [Penney, K mart, Montgomery Ward] will be doing something in the financial services arena where there's a card or something like that or some other avenue or vehicle." —Holly Klokis



proclaimed to analysts. "It will be a true financial services card." This is where the Sears Financial Network comes in handy. (At this writing the SFN players are: Allstate Insurance Group; Dean Witter, a securities brokerage firm; Coldwell Banker, a residential real estate firm; Sears Savings Bank in California, and Greenwood Trust Co. of Delaware, which will issue the card.)

For starters, Sears will offer cardholders the opportunity to open a Family Savings Account with tiered interest rates, increasing with account balances. The Greenwood Trust Co. will hold the accounts. Dean Witter will provide financial planning services including a self-directed IRA with no set-up fee.

Also, Sears is planning to provide cash access to Discover Card holders at automated teller machines. "The card will act as a credit instrument and cash withdrawn will be charged to the client's account," Brennan explained. There is also the possibility that the ATM's will eventually provide access to the cardholder's Family Saving Account.

However, said Brennan, "we will not establish a nationwide ATM network. We will have a shared position in some existing ATM markets across the country."

Sears has already gotten its feet wet with ATMs this past year. Reportedly, some customers of Dean Witter and Sears Savings Bank in San Diego were issued ATM cards for cash access to SearsNet, the Sears ATM net-

better serve middle-class individual households," the Sears president said of the company's financial services strategy.

The Discover Card is a natural outgrowth of Sears' existing financial services and what it found through consumer research, says Fred Wintzer, an analyst with Alex. Brown & Sons. "Sears research indicated that a sig-

Sears' Brennan claims consumers will be drawn to Discover by its ability to help them save and invest

nificant portion of the population wanted more sophisticated financial services such as banking and brokerage. But they were uncomfortable with the traditional outlets.

"Many consumers in the \$25,000 to \$40,000 income bracket didn't have money markets and didn't use a broker, but they were aware these services existed and wanted them," he reports. "Traditional banks and brokers are targeting to someone above that consumer." And, most important, Wintzer says, Sears found that a high percentage of these consumers were loyal Sears customers.

While neither American Express nor MasterCard would comment on Discover, H. Spencer Nilson would. Nilson, publisher of *The Nilson Report*, termed the new card "no industry threat."

It is unlikely to challenge Master-



Among warehouse stores surveyed, 75% reported weekly sales per square foot of selling area increased; 50% saw sales per gross square foot climb.

Combos take the lead in performance race

Chain Store Age Executive's supermarket survey shows combination stores to be consistently high yielders

Although superstores are viewed as the supermarket format of the future, combination stores still outperform them on a number of important productivity measurements.

Combos' leading performance is confirmed by the results of a recent survey of supermarket productivity conducted by *Chain Store Age Executive*. As the survey demonstrates they are consistently high performers on such key measures as average weekly sales per square foot of selling area and gross margins. This trend shows no signs of abating in 1985.

In addition to combination stores, the formats measured include conventional stores, superstores and warehouse stores. Operators of multiple formats broke out productivity statistics separately for each.

For purposes of this survey, combo stores are defined as being larger than 30,000 sq. ft. with general merchandise as at least 25% of the merchandise mix; superstores are larger than

30,000 sq. ft. and have expanded food and nonfood sections; conventional stores are smaller than 30,000 sq. ft.; warehouse stores are those with more limited product assortments and are of no specified size.

The average annual sales volume of the companies surveyed is \$577.6 million and the average number of store units is 111.

Among all of these formats, indications are that superstores will become the most plentiful. That's despite all the attention that has been focused lately on the super warehouse stores, or megastores, which now appear likely to account for no more than 5% to 7% of all U.S. supermarkets.

Emphasis not just on operations but on format has intensified in recent years as supermarket operators sought not just to reach a diverse customer base, but also to distinguish their operations from others in the marketplace. "You have to do something different to set yourself apart,"

points out Timothy Murphy, a leading industry consultant with Willard Bishop Consulting Economists, Barrington, Ill.

The growth of superstores is a direct reflection of this trend. Their numerous specialty departments enable such operators to present "something different." Plus, they provide a one-stop shopping destination for today's convenience oriented consumer.

At the same time, these and other operators are coping with the twin dilemma of keeping productivity on an upward trend while also developing an arsenal of new merchandising and design concepts.

Perhaps this dilemma is best illustrated when looking at sales per square foot. This measurement, especially when sales per square foot of selling area is utilized, is one of the most significant indicators when it comes to evaluating overall company performance, according to Murphy.

According to the survey, average weekly sales per square foot of selling area (used by 39% of the survey respondents) were highest for the combination stores in 1984 at \$27.60, followed by warehouse stores at \$25.10, superstores at \$20.80 and conventional stores at \$18.70.

However, this year those of superstores are seen as making the biggest leap, up to \$26.50 per square foot. In contrast, those of combination stores

Continued on page 25

are expected to remain stagnant at \$27.60, the same amount expected to be attained by the warehouse stores. Conventional stores see sales climbing to \$21.50 per square foot.

Any increase at all in sales per square foot is notable in view of the fact that stores are being built larger and larger. For example, *Chain Store Age Executive's* latest figures show the average new supermarket to be approximately 35,000 sq. ft. in size, while the average size of existing stores is approximately 30,000 sq. ft.

These larger stores are being filled not only with the traditionally high turn items that have made supermarkets successful despite their low profit margins, but also with much slower moving general merchandise.

"As a consequence, maybe sales per square foot will go down," points out Murphy, "but these operators are going into a whole new business. This means that there isn't necessarily anything wrong with their new numbers, only that they are comparing them with past performance overall. They really should be looking at sales on a department level."

Looking specifically at sales per gross square foot, superstores are way out in front, achieving \$320.50 per square foot last year. This figure is expected to climb to \$340.50 this year. They are followed by combination stores at \$280.80 in 1984 and are expected to go to approximately \$295.00 this year.

Those of conventional stores are also on the upswing, from \$225.40 to \$240.40 per square foot. On this measurement, warehouse stores are by far the laggards, at \$153.50 per square foot, unchanged from 1983.

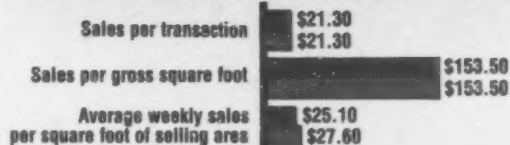
Superstores in particular need the hefty sales to offset a high 10.9% ratio of total store labor costs to sales. Combo stores come in second at approximately 10.6%. In contrast, warehouse stores, with their no-frills format, manage to contain costs to a mere 7.5%. Those at conventionals were still somewhat high at 9.4%.

This year the greatest improvement in containing these costs is being seen at the combination stores and at the warehouse stores. For the combos, this percentage is expected to fall to 9.4%, 6.2% at the warehouse stores. In contrast, superstores see labor costs declining only to 10.4%.

Perhaps because many conventional stores are adding more service departments in an effort to better compete with larger store formats, labor costs as a percentage of sales are expected to climb to 9.8%.

"Labor productivity is probably the No. 1 best measure of productivity," says Murphy. "Labor is the biggest operating expense for the super-

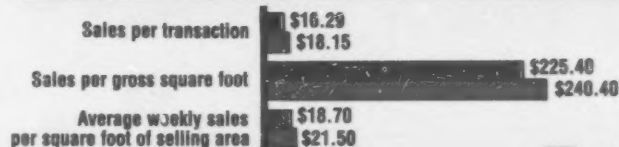
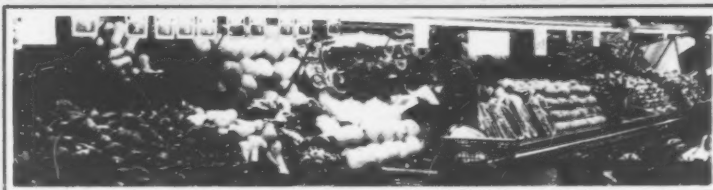
Warehouse stores



Source: Chain Store Age Executive research

1984 1985

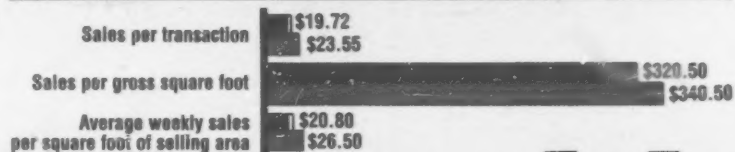
Conventional stores



Source: Chain Store Age Executive research

1984 1985

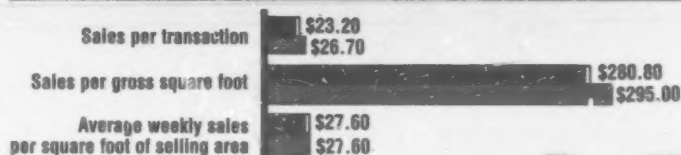
Superstores



Source: Chain Store Age Executive research

1984 1985

Combination stores



Source: Chain Store Age Executive research

1984 1985

Supermarket productivity measurements

	Conventional		Superstores		Combination stores		Warehouse stores	
	1984	1985	1984	1985	1984	1985	1984	1985
Net profit margin	15.2%	17.4%	10.4%	12.1%	10.5%	12.1%	9.4%	9.0%
Gross margin	20.7	21.6	20.3	20.8	21.3	21.6	16.0	16.8
Total store labor costs as % of sales	9.4	9.3	10.9	10.4	10.6	9.4	7.5	6.2

Source: Chain Store Age Executive research

market industry and it has to be controlled. How well it is controlled can spell success or failure."

Obviously both combination stores and superstores, with their greater preponderance of specialty service departments, are already battling the labor cost creep.

However, the situation is com-

ing Institute (FMI).

"Warehouse stores came into being during a time of high price inflation, but now that reason for being is disappearing," he points out. "As a result, they are starting to add more service departments, moving more upscale."

At the same time, "other store for-

profit margins to climb further, to 1.6%. Both combination stores and superstores expect to achieve a slight improvement, up to 1.2%, while those at warehouse stores are still seen remaining at a modest 1%, up only slightly from last year's figures.

For warehouse stores, the real key to their survival appears to be upping other productivity measures. Operators of this format seem to be having considerable success.

For example, 75% of the operators surveyed report average weekly sales per square foot of selling area increased from 1983 to 1984, 50% saw sales per gross square foot climb, and 49% managed to achieve an increase in sales per labor hour.

As a consequence of these achievements, 71% of this group were able to raise gross margins and 57% were able to increase net profit margins.

With combination and superstores often lowering their prices to meet the competition of warehouse stores and other aggressive operators, it's perhaps no wonder that such formats didn't experience quite the same degree of gross margin and net profit margin increase as did the warehouse stores. Thirty-eight per cent of those operating combination stores reported an increase in 1984 gross margins; 45% reported an increase in net profit margins.

Superstores did somewhat better in terms of gross margins, with 59% of these operators seeing an increase; however, only 33% experienced an increase in net profit margins. They were the big winners, though, in upping sales per transaction, achieved by 82% in 1984, and sales per gross square foot, 80%.

Perhaps even more remarkably, 100% of the combination stores saw sales per gross square foot climb over this same period, compared with 80% of the superstore operators, 64% of the conventional stores and 50% of the warehouse stores.

What's clear is that in their effort to appeal to a broadening base of consumers, supermarket operators still have one eye clearly focused on the bottom line. Retailers continue to consider productivity measures in selecting their ammunition for the battle of the formats.

Net incidence of productivity growth 1983 to 1984

	Conventional stores	Superstores	Combination stores	Warehouse stores
Gross margins	66%	59%	38%	71%
Sales per labor hour	59	61	90	48
Sales per transaction	60	82	50	40
Sales per gross square foot	84	80	100	80
Net profit margin	22	33	46	57
Average weekly sales per square foot of selling area	46	29	25	76
Total store labor costs as % of sales	(10)	—	—	22

Source: Chain Store Age Executive research

pounded by the fact that "Often it requires relatively more labor to move slower moving items," observes Murphy.

There's another side to the coin—gross profit margins. Here, again, according to the *Chain Store Age Executive* survey, in 1984 combination stores were the clear winner, at 21.3%, followed by conventional stores at 20.7%. Superstores averaged 20.3% while warehouse stores operated at 16%.

This year, combo stores are again expected to be the gross profit leader, achieving 21.6%. Conventional stores are seen as narrowly hanging onto the No. 2 spot with 21%, but closely followed by superstores at 20.8%. Warehouse stores are expected to achieve the biggest improvement, all the way up to 19.8%.

One reason for the strong showing by the warehouse stores is because the distinctions between these and other formats are blurring, according to a spokesman for the Food Market-

ing Institute (FMI).

Perhaps a bigger surprise is the strong performance of conventional stores. Many of the industry leaders have virtually abandoned this format in recent years.

The conventional store is, in fact, the leader when it comes to net profit margin, the productivity measurement used by 86% of the survey respondents. (Gross margin is used by 83% as is total store labor costs as a percentage of sales.) Such operators have been successful not only in containing labor costs, but also in controlling other expenses.

According to the *Chain Store Age Executive* survey, the 1984 average net profit margin was 1.5%, well above combination stores' 1.1%, superstores' 1.4% and warehouse stores' slim 0.9%.

During the current year, conventional stores are expecting their net